

pricing rules will adjust to competition is at the outset, not after some threshold level of competition has been reached.⁶⁸ This will allow new entrants, incumbent LECs, and customers, to make decisions based on a realistic expectation of associated costs and prices.⁶⁹

As made clear by Dr. Schankerman's analysis (in Section 3) of a two-stage game played by all potential market participants, the investment decisions made by both incumbent and entrant in the first stage of the game are based in part on expectations concerning the rules under which the second stage will be played. If pricing rules restrict the LECs' ability to compete, they will be deterred from making infrastructure investments which would have been socially desirable, while entrants may be induced to make inefficient investments. For this reason, reform of the Commission's pricing rules is needed not only to meet the goal of promoting effective competition, but to achieve the Commission's objective of developing an advanced, intelligent telecommunications infrastructure.

In the interexchange market, the Commission streamlined regulation of AT&T as competition developed. In the access market, where three customers (AT&T, MCI, and

⁶⁸ See, Dr. Schankerman's discussion at 12-13 about the relationship between entry decisions and regulatory restrictions that come into play after entry.

⁶⁹ "Incumbent LECs must be permitted to adjust their prices and products when competition starts -- not when competitors succeed. Otherwise, competitors will receive false economic signals and will make incorrect calculations about their ability to supply services in particular market areas." See, Attachment F, *Comments on the USTA Pricing Flexibility Proposal*, prepared by Richard Schmalensee and William Taylor ("*Schmalensee/Taylor Paper*") at iii.

Sprint) account for more than 90 percent of the demand, it is likely that competition will develop more rapidly than it did in the interexchange market.⁷⁰

It is important that the Commission act now to establish a framework for this transition, rather than attempt to deal with it after the fact and on an *ad hoc* basis. One advantage of this approach is that no particular threshold level of competition must be reached before the framework itself is established. If, in a particular market, competition has not yet reached the threshold or "trigger" level⁷¹ established as part of the framework, then adopting the framework will not affect the regulatory protection afforded customers in that market. However, some markets **will** meet the threshold at the outset and streamlining regulation selectively in those markets will benefit consumers there. Further, as additional markets satisfy the criteria, streamlining can occur in those markets with a minimum of delay, cost, and uncertainty if the procedure to be followed has been established in advance.

In summary: As competition develops in a market, the Commission, based on whatever criteria are selected as the determinant, should reduce regulation to permit competitive market forces to take control. This will provide the correct price signals to potential entrants and allow incumbent firms to compete effectively. The Commission should not wait until competition has reached some arbitrary threshold, but should

⁷⁰ *Staff Paper* at 31 n.44.

⁷¹ The Commission **seeks** comment (at paragraph 95) on what criteria should be used to determine when reduced or streamlined regulation should take effect. Whatever criteria are selected must have a so called "trigger" point which serves as an indication that regulation must change to meet the level of competition. In the next section, GTE discusses the pros and cons of the various criteria and recommends the one it believes will serve the Commission and the industry best.

adopt a new framework at the outset. This will allow new entrants, incumbents and customers to make realistic and economically correct decisions based on reasonable expectations.

B. Assessment of market power should focus on the relevant market for access. (*Transition Issue 1b*)

The Notice seeks comment (at paragraph 95) on the criteria the Commission should use to assess the degree of competition in an access market and on the design of an appropriate trigger mechanism which would adjust the Commission's rules as competition develops. In order to address these questions, one must first define the market to which the analysis will apply.

When the Commission evaluated the level of competition in the interexchange market, it considered the market on a national level. Customers for interexchange service wanted ubiquitous termination and the ability to use the service when they traveled. They also may have had more confidence in the ability of a large, nationwide carrier to meet their requirements. Within this national market, distinct submarkets existed for different services such as 800 service. The Commission therefore evaluated competition on a service-by-service basis, making its determination for each service on a nationwide basis.

The conditions in interexchange markets are very different from access markets which are essentially local in nature. The availability of an alternative supply in New York does the customer in Pittsburgh little good.⁷² The question of market power for

⁷² Clearly, customers for local access services are willing to accept a provider which lacks a nationwide presence. They have done so for years when they purchased local telephone service and cable TV service.

access services can be addressed most reasonably for a relatively small geographic area. Since no nationwide market exists for access, any market measure aggregated at a national level is without meaning. Such an aggregation would consolidate some local markets which are more competitive with some which are less competitive. By doing so, it would obscure the very differences across these markets that the Commission would be seeking to reveal through its trigger mechanism.

Within a market, access services are highly substitutable for one another. Most access services are sold at a wholesale level to large, sophisticated purchasers such as IXC's, Enhanced Service Providers ("ESPs"), and large end users. These wholesale markets are less subject to product differentiation than retail markets.

A customer can employ different arrangements of access services to satisfy the same demand. For example, the combination of a LEC special access facility and an IXC's Megacom-type service provides the end user with the same capabilities as the combination of the LEC's switched access and the IXC's message telephone service.⁷³ While today special access is a substitute for switched, increasing bandwidth and improved control features are allowing switched access to become a closer substitute for special access in the transmission of large quantities of data.⁷⁴ It is not reasonable

⁷³ Note that, in this example, the IXC becomes an alternative provider of local switching to the customer. In a Megacom arrangement, the customer's loop is homed on the IXC's switch which then becomes the first point of switching for that customer.

⁷⁴ Primary rate ISDN, Software Defined Networks, and configurable private line services all allow switched service to function in place of private line.

to define access markets on a service-by-service basis as the Commission did for interexchange markets.

In summary: GTE proposes that the main focus of the Commission's access market definition should be geographic in nature, and that the unit of observation chosen should be the smallest practical geographic area. A competitive assessment should be made for all interstate access services within a geographic market or for large groupings of services such as those in a price cap basket.⁷⁵

C. Addressability is the appropriate criterion for evaluating market power.

Where regulation is used as a substitute for competition, its purpose is to prevent the abuse of market power.⁷⁶ Therefore, in deciding when and where to reduce regulation as competition develops, the key criterion for the Commission should be whether the incumbent retains sufficient market power to raise prices above competitive levels. Once this market power has gone, the purpose of regulation has gone with it. Any mechanism for the streamlining of regulation in a new access charge framework should therefore be based on some indicator of market power.

⁷⁵ There may be some access services for which the relevant market is not well described by a small geographic area. Data base services and operator referral services are possible examples. Once the capability to provide such a service is established, it may become available over a relatively large geographic area. A service-by-service examination may be appropriate in these cases.

⁷⁶ See, Dr. Schankerman's discussion (at 5-11) on preemptive investment, vertical price squeeze, predatory pricing, and cross subsidization and their effect on competition. In Dr. Schankerman's analysis, a price cap plan with the features proposed here by GTE will provide regulatory protection, as needed, against these practices.

The degree of market power possessed by the incumbent firm is a function of elasticity of the firm demand curve faced by that incumbent. If that elasticity is relatively high, the firm will not be able to profitably raise prices above competitive levels.⁷⁷ This firm demand elasticity has two components. One is the elasticity of the final demand for the service -- this is the elasticity a sole provider would face in the absence of competition. The second component is determined by the customer's ability to shift to another supplier or to a substitutable service.

As competitive alternatives become available, this second component will increase. Any attempt by the incumbent to raise prices will drive customers to these alternatives. The issue of market power comes down to a simple question -- Does the customer have choices available? This is the essential criterion which should drive a trigger mechanism.

What begins as a question of demand elasticity therefore becomes a question of the availability of alternative sources of supply.⁷⁸ Is a provider of a substitutable service present in the relevant market? If customers chose to shift a significant amount of demand to that provider, would the provider have the capacity to serve that demand?

⁷⁷ In a textbook case of perfect competition, the firm's demand would be infinitely elastic. However, few markets actually look like the textbook case. In most markets that a reasonable person would consider highly competitive -- markets where intense rivalry exists among firms, where effective market pressure exists, and where customers benefit from innovation and low prices -- each firm has some market power. In fact, the incentive that drives quality improvement and new product development in these markets is each firm's desire to differentiate its product, and thereby create a measure of market power for itself. The goal of policy should therefore be to limit market power, but not necessarily to eliminate it.

⁷⁸ In other words, the elasticity faced by the incumbent firm depends upon the cross-elasticity of supply of substitutes provided by other firms.

Several possible indicators have been suggested by various parties as measures of LEC market power for access services. Some are indicators which the Commission has considered in its evaluation of AT&T's market power for interexchange services.

Some parties have proposed that the Commission delay streamlining regulation until competitors have attained some threshold level of market share.⁷⁹ It is claimed that only in this way can the Commission ensure that "effective competition" has arrived before it loosens the constraints on the incumbent. There are several problems with this approach:

Market share does not measure market power directly. Clearly, if the incumbent has a reduced market share, customers must have other choices available.

However, the existence of these choices -- which is what we are trying to measure -- need not result in any particular level of market share. A low market share is the result of customers exercising their choices in a particular way; it is not a determinant of the market outcome but part of that outcome.⁸⁰ A firm may have a relatively large share but little market power if customers have alternatives available. Conversely, a firm with a relatively small share may have considerable market power if its service is highly differentiated.

⁷⁹ See, for example, Teleport Communications Group, *The Unlevel Playing Field: Asymmetric Market Power Demands Asymmetric Regulation*, March 1994, at 12.

⁸⁰ See, Dr. Schankerman's discussion at 19-20. Market share does not cause market power. Market share is an endogenous variable which is determined by other fundamental factors in the market, including the elasticity of demand and the relative efficiency of firms.

Market share is a backward-looking indicator. It measures decisions which have been made in the past. If the trigger mechanism is based on market share, then decisions by new firms to enter a market and by customers to commit to purchase decisions will have been made inefficiently in response to distorted prices. A new regulatory framework cannot replicate a market result if it waits until these decisions have been made before it allows participants to respond to competitive prices.

The use of market share as a trigger presumes a certain outcome to the market experiment. By preventing a LEC from responding until a market share threshold is met, such policy may ensure that outcome by distorting prices and limiting the LEC's ability to meet customers' needs. Rather than promoting effective competition, this approach may prevent effective competition from developing.

Several IXCs have employed the misleading statistic that LECs receive more than 99 percent of the nationwide market for access.⁸¹ This claim is factually incorrect. Perhaps more importantly, it is irrelevant to an evaluation of market power in any particular access market. Finally, the IXCs' focus on LEC market share is inconsistent with their own positions with respect to the analysis of competition in interexchange markets.

⁸¹ See, *Petition for Waiver of the NYNEX Telephone Companies*, DA 93-157, Comments of Competitive Telecommunications Association at 3, AT&T Comments at 6, MCI's Opposition to Waiver, filed January 31, 1994.

Some nationwide market share estimates have compared IXC purchases of access from CAPs and LECs. These estimates ignore purchases of CAP access from end users. Today, a large percentage of LEC special access is purchased directly by end users. Similarly, many purchases of alternative providers' access services are made by end users, not IXCs. A significant shift in demand from LECs to alternative providers can therefore occur without affecting a measure of market share based on IXC purchases. In effect, the "99 percent" statement is tautological; it says that all the LEC access the IXCs buy is purchased from LECs.

Alternatively, IXCs have relied on comparisons of CAP revenues with LEC access revenues.⁸² Any comparison of revenues biases CAP market share downward, because CAPs have initially targeted high volume customers, who purchase high capacity services at rates which are much lower, on an equivalent per minute basis, than the average for all access.

Both of these measures focus exclusively on CAPs. They both therefore fail to count at all most alternative sources of access, such as self supply by the IXCs⁸³, private networks, wireless⁸⁴, cable⁸⁵, electric power companies, microwave, and satellite.

⁸² See, for example, Economics and Technology, Inc. and Hatfield Associates, Inc. *The Enduring Local Bottleneck*, February 1994, at ii.

⁸³ Self-supply by an IXC may involve extending a facility directly to end-users, or simply relocating its point of presence closer to its major customers.

⁸⁴ According to *Huber-Myth* (at 11), 70 percent of non-BOC cellular systems use some form of direct access to long-distance carriers. Cellular providers currently have 16 million subscribers, and roughly \$12 billion in annual revenue (*See Harris Paper* at Table B-8).

No measure of nationwide market share can give an accurate picture of whether a LEC has market power in a particular geographic market. The entire United States is not the relevant market for access services; it includes many small geographic markets, some of which are more competitive than others. For this reason, such nationwide numbers, even if accurate, would be irrelevant to the question of whether LEC access regulation should be streamlined in a particular geographic market.

Regardless of what the true market share is nationwide, it is clear that LECs have lost significant portions of certain markets. Bell Atlantic, for example, has documented a loss of 50 percent of the DS-3 market in the Washington metro area.⁸⁶ Similarly CAPs have captured 43 percent of high capacity transport services in New York City.⁸⁷ NYNEX has estimated that its share of the access market in New York State, for both switched and special access on an equivalent minute basis, is 80 to 85 percent.⁸⁸ Therefore, even if market share were the appropriate indicator of market power -- which it is not -- a nationwide view which aggregates many local access markets would not be useful. It also would not have any bearing on the reforms

⁸⁵ While cable firms are preparing to offer two-way switched telephone service, they are actively providing high capacity access services today. Cable firms have also partnered with IXCs to provide access for areas with concentrations of customers, such as university campuses. In New York, for example, Cablevision is providing access for AT&T to the C.W. Post campuses of Long Island University.

⁸⁶ See, *Competitive Market Area Demonstration and Data Reporting Requirements* (the "USTA Position Paper") which appears as an attachment to USTA's Comments.

⁸⁷ *Harris Paper* at B-6.

⁸⁸ Testimony of Ivan S. Siedenberg on behalf of USTA before the House Subcommittee on Telecommunications, February 9, 1994.

proposed here by GTE, none of which contemplate streamlining LEC regulation on a nationwide basis.

Finally, AT&T itself has consistently argued that market share should not be used to gauge market power: "AT&T does not agree that market share analysis is relevant to the issue of market power in the telecommunications industry."⁸⁹ AT&T declared itself fully competitive in 1984 when its market share, as measured by the Commission, was 84 percent of all interstate switched minutes. This is equivalent to NYNEX's estimate of its current share of the access market in New York State.

While market share should not be used to evaluate market power, several alternative indicators may be useful as components of a trigger mechanism. These include:

Capacity - For customers to be able to exercise their competitive choices, alternative providers must have sufficient supply capacity to satisfy their demand. In its evaluation of AT&T's market power, the Commission relied heavily on measures of the capacity of AT&T's interexchange competitors.⁹⁰ AT&T has strongly supported the use of capacity as an indicator of market power: "The most revealing measure of competition in the interexchange market is the substantial excess capacity now

⁸⁹ See, AT&T Comments filed February 24, 1986 in CC Docket No. 85-107, footnote on page 4.

⁹⁰ Competition in the Interstate Interexchange Marketplace, CC Docket No. 90-132 ("D.90-132"), 6 FCC Rcd 5880-5881, 5883-84, 5888-90 (1991) (subsequent citations omitted).

possessed by AT&T's competitors."⁹¹ AT&T argued that "the existence of this excess capacity precludes the exercise of market power by any carrier."⁹²

The ability of competitors to supply a product is also emphasized in the Justice Department's antitrust guidelines. The guidelines call for market shares to be calculated "using the best indicator of firm's future competitive significance." For markets where relatively undifferentiated, homogeneous products are involved, such as access, the guidelines call for "reserves of dollar production" to be used.⁹³

To evaluate AT&T's competitors' ability to supply demand that they might take from AT&T, the Commission examined data on capacity in the competitors' networks. In access markets, competitors are installing fiber facilities which have very large capacities. Further, once the fiber is in place, its capacity can be increased by upgrading the associated electronics.

A recent study by Pacific Bell has demonstrated that CAPs already have more than enough capacity in several California cities to carry all of Pacific Bell's demand in those cities.⁹⁴ It appears, therefore, that while capacity is an important indicator of market power, it may not be useful for the Commission to examine alternative providers' capacity on a case-by-case basis as part of a trigger mechanism. It is

⁹¹ See, AT&T Comments, *Competition in the Interstate Interexchange Marketplace*, CC Docket 90-132, filed July 3, 1990, at 12.

⁹² *Id.* at 30.

⁹³ U.S. Department of Justice, *Merger Guidelines*, June 1984. A recent revision of the guidelines (April 1992) calls for "physical capacity or reserves."

⁹⁴ *USTA Position Paper* at 10. In fact, CAPs have several times the capacity needed to carry 100 percent of the market in those cities. *Huber-Myth* at 9 estimates that no more than 10 percent of CAP fiber is currently in use carrying traffic.

reasonable for the Commission to conclude that fiber-based carriers generally will have enough capacity to carry the demand that is presented to them.

However, even if a carrier's fiber has a large cross-section of capacity, it may not be able to serve a customer's demand if it is not located near the customer's location. Therefore, the geographic reach of competitors' networks is an indicator of the competitors' ability to supply. The "addressability" indicator proposed by GTE incorporates this dimension of capacity.

Contestability - If there are no significant barriers to entry, the expectation of market entry will affect the behavior of the incumbent. When considering a price increase, the incumbent will consider the possibility that the increase will stimulate entry, and that the presence of the entrants will then make the increase unsustainable.⁹⁵ Given these conditions, market discipline will be exerted on the incumbent even if competitors have not yet constructed facilities. Such a market is said to be contestable.

A trigger based on satisfying the conditions for contestability would be soundly based in economic theory. However, it would require the Commission to find a market to be subject to competitive market pressure without any direct evidence of the presence of a competitor.

Addressability - GTE proposes a trigger mechanism dependent upon the proportion of access demand that is addressable by alternative providers. For a customer's demand to be addressable, an alternative provider must have facilities in-

⁹⁵ Baumol, William J., J. C. Panzar, R. D. Willig, *Contestable Markets and the Theory of Industry Structure*, Harcourt Brace Jovanovich, New York, 1982.

place near enough to a customer's location so that the provider can readily extend service to that customer upon request. In effect, this indicator asks directly the most basic question: Does the customer have alternatives available?

Unlike market share, addressability is a forward-looking indicator. It asks whether customers have choices rather than recording choices customers have made in the past. As part of a trigger mechanism, it allows the Commission to adjust its regulation after the LEC has lost market power, but before entrants have made all of their investment decisions and before customers have made their purchase decisions. Such a framework is more likely to promote effective competition and less likely to predetermine the outcome than a reliance on market share.

Unlike contestability, addressability is based on the physical presence of alternative providers with the capacity and geographic coverage to serve a substantial portion of the market. It allows the Commission to base its decisions on observed fact rather than prediction. At the same time, addressability is a very conservative indicator of market power since it essentially ignores part of the elasticity of supply. It does not rely on the expectation of future entry or the geographic extension of existing networks,

even though both events are likely and the anticipation of these events would affect the behavior of the incumbent LEC.⁹⁶

In summary: Addressability incorporates traditional indicators of capacity, but adds a measure of the alternative providers' ability to deliver services to the locations where customers want them. This feature makes addressability particularly suitable as an indicator of market power in access markets where demand, and the facilities needed to meet this demand, is more specific to particular locations than is the case in interexchange markets.

D. GTE proposes a framework for adjusting price cap regulation in access markets as competition develops.

GTE proposes a framework that would allow the Commission's pricing rules to be adjusted to match the degree of competition in each access market. GTE's approach is the same as that set forth in *USTA's Petition*.⁹⁷ This framework has three main elements:

⁹⁶ A criterion based on contestability would have the advantage that it would allow LECs to establish more correct pricing signals in a market before an entrant has actually made any investment. It would therefore be less likely to induce inefficient investment. A criterion based on addressability might permit some inefficient investment to occur before the LEC could respond. However, since it is based on the actual presence of some alternative facilities, addressability provides an additional safeguard against preemption or other anticompetitive behavior by the incumbent. To maintain this safeguard while minimizing the likelihood of inefficient investment, it is important for the Commission to establish a clear framework, based on addressability, in advance. Potential entrants would then be able to make their investment decisions based on a clear expectation of the LEC's response. See, Dr. Schankerman's discussion at 17.

⁹⁷ Attachment 7 to *USTA's Petition* sets out proposed rules to implement this framework. See in particular Part "Y."

- 1) The establishment of market areas which correspond to relevant access markets.
- 2) A trigger mechanism which classifies each market area as an Initial Market Area ("IMA"), a Transitional Market Area ("TMA"), or a Competitive Market Area ("CMA") depending on the degree of market power found in each area. The proposal includes the criteria on which these triggers would be based.
- 3) The pricing rules which would apply in IMAs, TMAs, and CMAs. The more competitive the market area, the greater the flexibility provided under the rules.

USTA's Petition uses the existing zone pricing plan as the basis for its market area classification. At the outset of the plan, each zone would be classified as an IMA. When an appropriate trigger point, determined in advance, is reached within a given IMA wire center, that wire center would be incorporated into a TMA. Thus, once the starting point of the plan has been established, the relevant market to which the trigger mechanism would apply is the area served by a LEC wire center.

In principle, the size of each market area will vary depending on the economics of demand and supply in a given region. However, in order to make a plan simple, predictable, and practical to administer, GTE proposes that the units of observation should be determined in advance, and that they should correspond to an area that is already used in tariffs, operating systems, and ordering and billing systems. The wire center is the existing unit which most closely approximates the scope of an economic

market for access.⁹⁸ When a wire center can be shown to satisfy a more stringent set of criteria, a second trigger point is reached, and the wire center is classified as a CMA.

The standard used to trigger the classification of a wire center as a TMA is simply the presence within the wire center serving area of an alternative provider of substitutable services. This could be demonstrated by the presence of an expanded interconnection arrangement in the wire center. In order to trigger the creation of a CMA, a wire center must satisfy following criteria:

- 1) That customers within the serving area of the wire center, representing at least 25 percent of the demand for the LEC's interstate access services or 20 percent of the total market demand for interstate access services within that area, have available to them an alternative source of supply; and
- 2) That customers in the serving area of the wire center, whose demand represents at least 25 percent of the total demand within that area for the LEC's interstate access services or a single customer whose demand represents at least 15 percent of that total, actively seek to reduce the cost of their access services through the solicitation of bids, use of private networks, or construction of their own facilities.

⁹⁸ See, *Schmalensee/Taylor Paper* at 24. While the serving area of a wire center is the smallest unit of analysis in this framework, the USTA proposal would also allow a showing to be made for a group of wire centers. Schmalensee and Taylor believe that an economic market for access is likely to be larger than a wire center area. See also Dr. Schankerman's discussion at 18.

The first criterion is based on an indicator of the proportion of the market that is addressable by competitors. The second criterion measures the ability and willingness of customers to take advantage of the choices available to them.⁹⁹

In summary: The Commission should adopt a price cap mechanism that adjusts the degree of regulation to match the degree of competition in each market area. This will allow consumers to benefit from effective competition wherever possible, while retaining price cap protection wherever necessary. By establishing this framework now, the Commission can allow all market participants to base their decisions on reasonable expectations, and can allow the price cap plan to adapt quickly to future changes, without the need for additional proceedings. The plan should be based on a reasonable definition of a geographic access market, and should focus on addressability as a measure of market power.

E. Carriers should be required to provide information on their serving areas.

In general, GTE does not recommend that regulatory symmetry be achieved by increasing regulation of alternative access providers. However, there is one new requirement that the Commission should place on these firms. In order to assess the competitiveness of a market area, the Commission will require basic information concerning the areas where carriers provide service.

⁹⁹ Schmalensee and Taylor have examined the criteria described here, and find: "Given the degree of pricing flexibility requested, the proposed criteria to classify access markets as Transitional Market Areas (TMAs) are probably conservative, and the Competitive Market Area (CMA) criteria are certainly reasonable." *Schmalensee/Taylor* at iii.

In the past, the Commission has relied on exchange carriers to provide information on other segments of the industry. For example, the Commission's reports on IXC market share are based on reporting of access minutes by the LECs. As other access providers grow, these LEC data will provide a less accurate picture of both the interexchange and access markets.

Exchange carriers have made efforts to collect data on alternative providers as part of their market research, and have shared some of this information with the Commission. This information is useful in establishing a broad picture of the state of competition today, as a basis for adopting a new regulatory framework. However, the Commission should not expect LEC market research to provide, on an ongoing basis, all of the information needed to develop a showing that the addressability criterion has been met in a market area. First, it is becoming increasingly difficult for LECs to obtain this information. Second, it is unreasonable to expect LECs to be the Commission's source of information for services they do not provide.

GTE therefore proposes that a CAP or other firm providing access as a common carrier should be required to provide a clear indication in its tariff of the area in which it stands ready to provide service.¹⁰⁰ Exchange carriers today file serving area maps in their tariffs which allow a customer to determine where service can be obtained from the LEC. If carriers are not required to provide this information in their tariffs, they should be required to report the locations of their facilities. Exchange carriers are

¹⁰⁰ Some additional reporting requirement may be appropriate for entities other than common carriers.

required today to provide facility maps as part of their Section 214 applications when they wish to enter the broadband video market.

The information provided through this process could be used directly by an exchange carrier to prepare a showing that a market area meets the criteria to be designated a CMA. It could also be used by the Commission to track the availability of service in markets across the country. The proposal would provide the minimum information needed to assess the competitiveness of access markets, while minimizing the burden imposed on any carrier.¹⁰¹

In summary: GTE proposes that carriers should report to the Commission the minimum information needed to assess the competitiveness of access markets.

4. Basket design and pricing rules should be reformed to reflect competition. (*Baseline Issue 2 & Transition Issue 3*)

GTE supports *USTA's Petition* and the reconfiguration of baskets and bands contained in that proposal. The existing baskets would be replaced with four new baskets: Switching, Transport, Public Policy, and Other.

For IMAs, the Switching and Transport baskets would have subindices, called Market Area Band Indices ("MABIs"). These subindices would have pricing bands of +5/-10 percent in a given year. New service rates would be justified by showing that they cover incremental cost, and that they are reasonable.

¹⁰¹ Attachment 9 to USTA's comments in this proceeding describes this proposal in greater detail. It also provides illustrative examples of how the information made available through this requirement could be used to develop a competitive showing for a market area.

Services in a TMA would be subject to similar price cap rules, except that the lower banding constraint would be 15 percent. LECs also would be able to respond to a request for proposal from a customer in a TMA with a contract tailored to the customer's needs. These contracts would be offered under tariff, as AT&T's Tariff 12 contracts are today. New services would be justified using a net revenue test. Tariff notice periods would be shorter than those for services in an IMA. Services in a CMA would be removed from price cap regulation. Any CMA service could be offered under a customer-specific tariff similar to that for AT&T's Tariff 12 offerings. However, all CMA services would continue to be regulated as tariffed, Title II services.¹⁰²

The basket and band design proposed by USTA, and which GTE supports, would place rate elements into simple, logical groupings on a functional basis. This would make it more straightforward to assign new elements to baskets and would minimize the difficulty in classifying new services the Commission has encountered in the past.¹⁰³ The proposed baskets are designed in such a way that they can be defined in the rules without reference to a codified Part 69 structure.¹⁰⁴ They also are designed to complement the proposed structure of market area classification. The

¹⁰² Based on their examination of this framework, *Schmalensee-Taylor* at ii: "conclude that the USTA proposal is sound, and its adoption would serve the public interest. [It] would benefit the customers, who would be able to purchase access services from the LECs, [CAPs], or other competitors at the most efficient and lowest price."

¹⁰³ See, Dr. Schankerman's discussion at 14-15.

¹⁰⁴ *USTA's Petition*, Attachment 7, Part "Y". The Commission recently modified the basket structure by creating a new Trunking basket. See *Transport Rater Structure and Pricing*, CC Docket No. 91-213, CC Docket No. 91-213 ("D.91-213"), Second Report and Order, 9 FCC Rcd 615 (1994). This step brings the basket structure closer to that proposed by USTA.

proposed baskets minimize the need to realign the basket structure to accommodate changes in competition while at the same time effectively segregating more competitive markets from less competitive ones.

The Notice seeks comment (at paragraph 41) on the appropriate means for grouping less competitive rates into a separate basket so that the price cap protection afforded customers who rely on those services is not affected by the LEC's experience in more competitive markets. The proposed structure accomplishes this goal in two ways:

First, it uses separate subindices ("MABIs") to group rates for IMAs and TMAs within each functional basket, which provides the required protection without the need to recompute the basket level indices each time a market is reclassified from IMA to TMA.

Second, the most competitive markets are removed from price caps and would therefore have no effect on the caps in less competitive markets.¹⁰⁵

In summary: GTE supports *USTA's Petition* which proposes a basket and band design that groups rate elements into simple, logical groupings on a functional basis.

5. Asymmetric regulation is only justified when two specific criteria are met. (*Baseline Issue 9*)

The Commission further seeks comment (at paragraph 86) on whether other rules and policies should be revised to equalize treatment in general between LECs and CAPs. GTE supports symmetric treatment of LECs and all other providers. Increasing competition is eliminating the market power that once allowed the

¹⁰⁵ See, Dr. Schankerman's discussion at 11 and *Schmalensee/Taylor* at 39.

Commission to use LEC rates as a device for balancing the interests of other parties.

As Dr. Schankerman states (at 2):

Symmetric regulation means providing all suppliers, incumbents and new entrants alike, a level playing field on which to compete - the same price signals, restrictions, and obligations. Full symmetry must encompass all stages of market participation: entry, post-entry competition, and exit.

In arguing for regulatory symmetry, GTE does not advocate increased regulation for competitors such as CAPs, but rather streamlined regulation for LECs in those markets it is shown that customers have alternatives available.¹⁰⁶

GTE concurs with Dr. Schankerman's assessment (at 3) that asymmetric regulation is appropriate only if (i) there is a demonstrated capacity of an incumbent to strategically deter entry unrelated to an efficiency advantage; and (ii) asymmetric regulatory treatment is the least costly way to control their behavior.

Dr. Schankerman examines (at 3-8) four practices that allegedly deter entry or induce exit: (1) preemptive investment; (2) vertical price squeeze; (3) predatory pricing; and (4) cross subsidization. He concludes:

(1) The scope for effective preemption in the current telecommunications market is limited — especially for preemption in services. The framework proposed by GTE would also protect against the remote possibility of preemption, since it would relax LEC pricing rules only after entrants had facilities in place.

¹⁰⁶ GTE's proposals for price cap reform are conservative: If the Commission were to adopt all of these proposals, exchange carriers would still be subject even in CMAs to greater regulatory constraints than CAPs are today.

(2) Vertical price squeeze could be controlled by requiring that some facility competition be present before authorizing regulatory streamlining in a geographic market.

(3) Predatory pricing is unlikely given the structural condition (technology and demand) in telecommunications -- especially with open network architecture, unbundling, and mandated interconnection. In any event, asymmetric regulation is not required to address this issue as price floors based on incremental cost prevent predation.

(4) The most effective means of minimizing cross subsidization is to segregate geographic markets and impose separate price caps according to the extent of competition.

The Commission seeks comment (at paragraph 86) whether "current rules for computing AT&T's exogenous access costs should be revised to equalize the treatment of LEC and CAP access rates in the calculation of AT&T's exogenous access costs." This is another example of the asymmetric treatment of LECs and CAPs.¹⁰⁷ Since AT&T has not been required to flow-through CAP changes, an incentive has been created for AT&T to purchase access from non-LEC suppliers. Therefore, GTE

¹⁰⁷ GTE has argued against asymmetric regulation when circumstances do not warrant it in other pleadings and continues to support that position in this pleading. *Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, GTE's Petition for Reconsideration, filed December 18, 1992, at 24-26; *D.91-213*, GTE's Reply Comments, filed March 19, 1993, at 20-23; *NARUC's Request for a Notice of Inquiry Concerning Access Issues*, DA 93-847, GTE's Comments, filed September 2, 1993, at 3; *Staff Paper*, GTE's Comments, filed September 23, 1993, at 4; *NYNEX Transition Plan to Preserve Universal Service in a Competitive Environment*, DA 93-157, GTE's Comments, filed January 31, 1994, at 4.

believes that the Commission must revise its rules so that LECs and CAPs are treated equally. The Commission should require AT&T to treat its payments of access charges to either LECs or CAPs the same way – whether exogenous or endogenous – so as not to create a built-in bias in the market favoring CAPs.

In summary: Asymmetric regulation does not further the Commission's goals nor does it provide the benefits of a competitive marketplace. A price cap plan that incorporates the recommended elements – geographic markets with competitive criterion, separate price caps, and price floors based on incremental cost – will make further asymmetric regulation unnecessary. A price cap plan designed in this manner will give exchange carriers the pricing flexibility necessary to compete with other industry participants, and would allow market forces to guide efficient investment in the NII.

6. Sharing is no longer required. (*Baseline Issue 4*)

Sharing – together with the low-end adjustment mechanism – should be eliminated from the price cap plan because:

(1) They are no longer required as a backstop mechanism for the productivity offset; and

(2) They reintroduce into price caps out-moded rate-of-return regulation, negating important benefits of price caps.

Sharing was instituted as a backstop mechanism for the LEC productivity offset to compensate for any error in the productivity factor adopted, and not as a means of determining just and reasonable rates. The Commission also reasoned that a backstop